

Summary Analysis of TransCanada Contingent Liability Issues

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Report prepared by

**Allan Van Fleet
Ken Minesinger
Don Shepler**

**Greenberg Traurig
2101 L Street, N.W.
Suite 1000
Washington, D.C. 20037**

SUMMARY ANALYSIS OF TRANSCANADA CONTINGENT LIABILITY ISSUES¹

As discussed in detail in other Greenberg Traurig memoranda, we believe the chances are extremely small that, if subsidiaries of TransCanada Corporation build a natural gas pipeline pursuant to their pending AGIA application, former partners of other TransCanada subsidiaries could prevail on claims that they are entitled to billions of dollars under a decades-old partnership agreement from which they withdrew. We believe it is even further remote that the former partners could successfully assert tort claims against third parties – such as joint venturers, shippers, financiers, or the State of Alaska – who work with TransCanada on the AGIA project. Finally, we believe that whatever the strength of the state law claims the maximum liability is more in the range of approximately \$200 million, rather than the \$10 billion or so that has been mentioned in the Alaskan proceedings.

Nevertheless, a common tactic of dominant corporations is to use a strategy of fear, uncertainty and doubt to discourage others from dealing with competitors. We therefore suggest procedural and contractual steps that parties can take to deal with that strategy and further reduce the risks that thus far are espoused only by AGIA's opponents.

INTRODUCTION

TransCanada subsidiaries TransCanada Alaska Company, LLC and Foothills Pipe Lines Ltd. (the "TransCanada Applicants") filed the only application to comply with all the requirements the Alaska Legislature set forth for a license under the Alaska Gasline Inducement Act ("AGIA"). ConocoPhillips and BP, two of the largest lessees of Alaska North Slope ("ANS") natural gas reserves, refused to participate in the AGIA request for proposals process. Recently, they been

¹ This paper was prepared by Allan Van Fleet and Ken Minesinger of Greenberg Traurig, with assistance from other litigation, corporate and regulatory attorneys at Greenberg Traurig.

publicly promoting their own proposal to build a gas pipeline, presumably in return for Alaska's granting ConocoPhillips, BP and Exxon (the "Major North Slope Producers") billions of dollars in tax and royalty concessions. In public comments on the AGIA application submitted by TransCanada, the Major North Slope Producers have raised the specter that TransCanada (along with anyone who works with TransCanada pursuant to AGIA) risks exposure to billions of dollars in liability claims by former partners of the Alaskan Northwest Natural Gas Transportation Company (the "Partnership").

The Partnership Agreement Creates and Limits the Contingent Liability.

The Partnership was formed in 1978 as a New York general partnership to construct and operate the Alaska Natural Gas Transportation System ("ANGTS") pursuant to the Alaska Natural Gas Transportation Act of 1976 ("ANGTA"). Section 3.3 of the General Partnership Agreement dated as of January 31, 1978 (the "Partnership Agreement"), anticipated that the "Line" would be put in operation by January 1, 1983 or "as soon thereafter as practicable." Each partner was required to make an initial capital contribution equal to its pro rata share of up to \$24 million and then to make annual capital contributions in the amount set by the Partnership's Board of Partners. Partners who did not wish to continue contributing could withdraw.

There were 11 partners in 1978. Partners began withdrawing in 1981; the last partner not affiliated with TransCanada withdrew in 1994 (all withdrawn partners are referred to as "Withdrawn Partners"). The only remaining partners are TransCanada PipeLine USA Ltd., and United Alaska Fuels Corporation (the "TransCanada Partners"), both of which are indirect, wholly owned subsidiaries of TransCanada. TransCanada is also the current ultimate parent of three of the Withdrawn Partners.

The Partnership Agreement limits the rights of partners that withdraw from the Partnership. Section 15.2 specifies that the Withdrawn Partners have “those rights stated in Section 4.4.4, but no others.” Section 4.4.4 of the Partnership Agreement provides that any Withdrawn Partner is only entitled to receive, “after the Line has become operational and at a time when the Executive Committee determines payment may be made without undue hardship to the Partnership...(a) an amount equal to its Capital Account ... and (b) return on such amount, from the date of withdrawal to date of payment, calculated at the rate permitted by the Federal Energy Regulatory Commission (“FERC”) to the Partnership as the Partnership’s allowance for such funds used during construction.” In June 1979, FERC issued Order No. 31 preliminarily setting the Partnership’s annual rate of return, which would also be used to calculate its allowance for funds used during construction, at 14% per annum for the Alaska segment. *See Determination of Incentive Rate of Return, Tariff and Related Issues*, Order No. 31, 7 FERC ¶ 61,237 at 61,447 (1979).

Section 4.4.4(i) of the Partnership Agreement states that “[t]he Capital Account balance of a Withdrawing Partner shall be recorded as a contingent liability [“Contingent Liability”] of the Partnership, and not as a Partner’s Capital Account, from and after the Date of Withdrawal” and that Withdrawn Partners’ rights to reimbursement are subordinate to the rights of the Partnership’s other creditors. We have assumed, based on a review of filings made by the Partnership at FERC, that the Contingent Liability is approximately \$10 billion.

ANALYSIS

The Contingent Liability Is Not the Debt of the TransCanada Applicants or Their Parent.

The Contingent Liability, if it exists at all, is first and foremost the debt of the Partnership. It is uncertain, under New York law, whether and to what extent individual partners would be

liable for that debt should Partnership assets be insufficient to satisfy it. It is unlikely that it would be found that the remaining TransCanada Partners alone would be liable for any shortfall.

On the other hand, it appears clear that the TransCanada AGIA Applicants would not be liable for the shortfall. The TransCanada Applicants are Delaware corporations, and it is extremely difficult under Delaware law to “pierce the corporate veil” to make properly created and maintained corporations liable for the obligations of their affiliates. *See, e.g., In re Phillips Petroleum Securities Litigation*, 738 F. Supp. 1116, 1126 (D. Del. 1990) (“The courts of Delaware do not easily pierce the corporate veil”). It would have to be shown that the TransCanada Partners were created to perpetuate a fraud on the Partnership or other Partners, that they were inadequately capitalized, or that they so lacked any independent existence as to have been “pure agents” of the TransCanada parent in connection with the Partnership. We have not seen any evidence to support disregarding the independent corporate existence of the TransCanada Partners and imposing the Contingent Liability on the TransCanada Applicants or their parent.

The TransCanada Applicants Have Not Breached Any Fiduciary Duty to the Withdrawn Partners.

Because of a split among the New York courts, it is unclear whether the remaining TransCanada Partners owe a fiduciary duty to the Withdrawn Partners. Nevertheless, we believe it is extremely unlikely that such a duty, if it exists, would prevent the TransCanada partners from pursuing – as have several of the Withdrawn Partners – an Alaska gas pipeline project apart from the Partnership. Such an interpretation of the Partnership Agreement would effectively turn it into a 25-year (indeed, perpetual) covenant not to compete, which we believe would contravene Alaska and U.S. antitrust laws. It is no coincidence that companies with a dominant market position on the North Slope have argued, in effect, that the one company with an AGIA-compliant proposal to

build a gasline to the North American consuming market is, for all intents and purposes, forever precluded from doing so. Their argument proves too much.

Moreover, we believe it is clear that the TransCanada Applicants – who are not parties to the Partnership Agreement – have no contractual or other duty to refrain from pursuing an independent pipeline project pursuant to the AGIA process. This is confirmed, we believe, by the fact that none of the Withdrawn Partners has objected to the TransCanada Applicants’ AGIA application or asserted that it represents a Partnership “opportunity” in which they are entitled to participate. All of the Withdrawn Partners have had notice of the Application for some time, as each of them received a letter from the Majority Leader of the Alaska House of Representatives about these issues. Nevertheless, none of the Withdrawn Partners filed public comments during the AGIA process, and thus have failed to assert any claims against the TransCanada Applicants.

Indeed, Sempra Energy, the ultimate parent of one of the Withdrawn Partners, recently stated in writing to the Alaska Legislative Budget & Audit Committee that, based on the available information “regarding the manner in which TransCanada is proposing to carry out the project, we are not aware of any obligation under the ANNGTC General Partnership Agreement that is being violated by TransCanada.” Letter from Javade Chaudhri, Sempra Energy to Rep. Ralph Samuels, Chair (April 1, 2008).

In addition, any attempt by a Withdrawn Partner to assert such claims after the issuance of a License to the TransCanada Applicants would be subject to various defenses such as waiver, estoppel and failure to exhaust administrative remedies, and could conceivably expose the Withdrawn Partner to liability for interfering with the State’s contractual license relationship with the TransCanada Applicants.

Third Parties Dealing With the TransCanada Applicants Would Not Be Liable to the Withdrawn Partners.

We believe it is extremely remote that third parties – joint venturers, shippers, financiers, or the State – could be liable to the Withdrawn Partners on any theory.

Assuming, against all odds, that the TransCanada Applicants are found to have any contractual liability for the Contingent Liability, joint venturers of the TransCanada applications do not assume any part of that liability, unless they expressly choose to do so in the joint venture agreement.

Nor would they be subject to liability under theories that they tortiously interfered with the Partnership Agreement or induced the TransCanada Applicants to breach fiduciary duties to the Withdrawn Partners. First, as explained above, we believe the TransCanada Applicants themselves could not be held liable for any breach of the Partnership Agreement or fiduciary duty to the Withdrawn Partners. Even if they could, a third party could not be found liable unless it caused the breach. If there has been any breach, the TransCanada Applicants have already committed it, and a third party who later works with them on the AGIA pipeline could not be found to have induced the breach.

This analysis applies to all third parties, including joint venturers in the construction and operation of the pipeline, shippers who commit to use the pipeline, parties that finance the project, and the State in providing incentives for the project. Indeed, to hold the State liable, a Withdrawn Partner would have to prove not only the interference elements noted above, but that the Legislature and Executive acted unconstitutionally in enacting AGIA and following its provisions to induce the TransCanada Applicants to pursue the pipeline.

We believe claims that financial institutions working with the TransCanada Applicants expose themselves to liability to the Withdrawn Partners for tortious interference to be especially weak, intended only to interfere with TransCanada's ability to finance the AGIA pipeline. To hold a financial institution liable for tortious interference, it must be shown that the institution *knew* that the TransCanada Applicants had a contractual or fiduciary duty not to pursue the AGIA pipeline, that the institution *caused* the TransCanada to breach its duties, *and* that the financial institution itself had a fiduciary relationship with the Withdrawn Partner. We believe the confluence of these conditions to be so remote as to call into question the good faith and motivation of any party which suggests that banks or other institutions financing the AGIA pipeline are exposed to such liability.

The FERC Is Unlikely To Allow Any Substantial Amount of the Contingent Liability To Be Included in the AGIA Pipeline Rate Base.

If it were found, notwithstanding all of the foregoing, that TransCanada or its affiliates were subject to Section 4.4.4 of the Partnership Agreement as a result of constructing an Alaskan pipeline, we also believe there are compelling reasons arising from FERC law and practice for rejecting a claim for payments by Withdrawn Partners .

Under longstanding and well understood regulations and policies, the Alaska gas pipeline would likely be prohibited from recovering in its rates any return on the capital contribution for the decades during which no work has been done, a disallowance eliminating more than 95 percent of the Contingent Liability. Indeed, it likely would be denied recovery of any portion of the ANNGTC equity payments whatsoever, if the assets the payments represent are not actually used in the AGIA pipeline project. In this event, any Contingent Liability of the Partnership would likely be reduced to less than \$200 million, and even this exposure is, at best, uncertain. There are several reasons for this conclusion.

First, in our view the most reasonable interpretation of the Partnership Agreement is that, in order for there to be any obligation to repay capital contributions, the payments must be recoverable by ANNGTC in its FERC-regulated rates. Under this interpretation, an inability to recover the Partnership's payment in its rates directly reduces the obligation to pay on a dollar for dollar basis. Because FERC regulations likely limit rate recovery to no more than \$500 million, the Partnership's obligation to pay Withdrawn Partners would be commensurately reduced. Even if the Partnership Agreement were not so construed, however, other provisions of the Partnership Agreement operate to relieve the Partners of this obligation. Clearly, if the Partnership Agreement in fact required such payments to be made even though not recoverable in the pipeline's rates, the massive financial loss that would result would mean that the pipeline could never be financed or built and thus fail to satisfy the requirement of Section 4.4.4 that the line "become operational". The Partnership Agreement, in any case, shields the Partnership from an obligation to make payments to Withdrawn Partners if to do so would impose "undue hardship". We can think of no reasonable argument why incurring a multi-billion dollar loss would not constitute an "undue hardship."

Steps To Eliminate Fear, Uncertainty and Doubt.

As noted, to our knowledge *none* of the Withdrawn Partners has publicly asserted any claim or suggestion that if the TransCanada Applicants build the pipeline pursuant to AGIA that they are entitled to the Contingent Liability or compensation under any theory of law. The issues have been raised by parties interested in seeing the TransCanada AGIA Application fail, so that they can pursue their own proposal in return for tax and royalty concessions by the State, or simply continue to warehouse the State's ANS gas.

Given the inherent weakness of the claims by these parties, we do not believe it should be necessary to obtain clarification of the parties' legal obligations. Nevertheless, we suggest procedural and contractual measures that parties may take to reduce further or eliminate the possibility of exposure to the liability that AGIA's opponents pose, including the following:

FERC Proceeding

The TransCanada Applicants – or the State or interested shippers for that matter – may initiate a proceeding before the FERC to obtain a determination whether any part of the Contingent Liability could be included in the rate base of ANNGTC or the AGIA pipeline, or whether it would be disallowed in whole or in part. As discussed above, we believe that, if such a proceeding were initiated and FERC reached the merits of the issue, FERC would disallow most of the Capital Accounts as not reflecting assets that were used or useful in either the ANNGTC project or the AGIA pipeline. In particular, we believe the FERC would prohibit recovery of the billions of dollars in high interest that constitutes the overwhelming bulk of the Contingent Liability.

Declaratory judgment action in Alaska or New York court

In addition, the TransCanada Applicants (or TransCanada Partners) could file a declaratory judgment action against the Withdrawn Partners in Alaska or New York court to determine whether they owe any contractual, fiduciary or other duty to pay the Contingent Liability or refrain from pursuing the AGIA pipeline. The declaratory judgment action would also resolve any question whether third parties could be liable for tortious interference with those duties.

Partnership bankruptcy proceeding

The remaining TransCanada Partners also could file bankruptcy proceedings on behalf of the Partnership to determine the amount, if any, of the Contingent Liability if the TransCanada

Applicants build the AGIA pipeline. The Partnership could also use the bankruptcy proceedings to restructure or extinguish the Contingent Liability. The bankruptcy filing could also be used as the vehicle to dissolve the Partnership and sell such assets that it has to parties who can best use them, applying the proceeds to pay off the current and Withdrawn Partners (5 of 11 of which are TransCanada subsidiaries).

Contractual and corporate protections

Third parties dealing with the TransCanada Applicants may design their contracts and corporate structures to further reduce exposure to even the remote liability possibilities that AGIA opponents posit.

First, the joint venture or other agreement could provide expressly that those working with the TransCanada Applicants assume none of their liabilities, if any.

Second, the joint venture or other agreement can include express representations and warranties by the TransCanada Applicants that there are no legal impediments to their pursuing the AGIA pipeline and that there are no contingent liabilities (including the Contingent Liability) other than those listed. The joint venture agreement can include indemnification provisions for breach of the representations and warranties, and we believe no public policy would prevent indemnification for their breach.

Third, joint venturers can protect themselves by creating a Delaware Limited Liability Company (“DLLC”) as the vehicle for the joint venture. Under Delaware law, a DLLC protects joint venturers from the liabilities of other venturers. The DLLC documents can include express covenants holding the DLLC separate from the venturers and the venturers separate from each other.

CONCLUSION

We believe the exposure to significant liability to Withdrawn Partners by the TransCanada Application, let alone third parties who deal with them, to be extremely remote. The specter of such claims has been raised not by any Withdrawn Partner, but by opponents of AGIA, which have their own motivations to see the TransCanada Applicants' AGIA efforts fail. Nevertheless, we have suggested measures interested parties may take to further reduce or eliminate the fear, uncertainty and doubt that AGIA's opponents have attempted to foment.